

1
2
3
4 IN THE UNITED STATES DISTRICT COURT
5 FOR THE NORTHERN DISTRICT OF CALIFORNIA
6

7 JOHN H. SYKES, an individual,) Case No. 10-3858 SC
8 Plaintiff,)
9 v.) ORDER GRANTING MOTION FOR
10) PRELIMINARY INJUNCTION
11 ROSADIA D. ESCUETA, an individual;)
12 PAUL THORNTON, an individual;)
13 CHONG A. IM, individually and as)
14 the trustee of the Chong A. Im)
15 Trust dated 9/21/07; KEVIN IM, an)
individual; and JACKIE IM, an)
individual,)
16 Defendants.)
17

I. INTRODUCTION

Before the Court is a Motion for Preliminary Injunction brought by Plaintiff John H. Sykes ("Sykes"). ECF No. 11 ("Mot."). Sykes seeks to enjoin Defendants Rosadia D. Escueta, Paul Thornton, Chong A. Im (individually, and as trustee of the Chong A. Im Trust dated September 21, 2007), Kevin Im, and Jackie Im (collectively, "Defendants") from proceeding with claims against him before the Financial Industry Regulatory Authority's Arbitration Panel ("FINRA"). Id. This Motion is fully briefed. ECF Nos. 13 ("Opp'n"), 16 ("Reply"). For the following reasons, the Court GRANTS Sykes's Motion.

28 ///

1 II. **BACKGROUND**

2 Defendants are investors and former clients of Donald R.
3 Dunakin III ("Dunakin"), an investment broker. See Mot. Exs. B
4 ("Thornton FINRA Claim") ¶ 2, C ("Escueta FINRA Claim") ¶ 1, D ("Im
5 FINRA Claim") ¶ 3 (collectively, "Defs.' FINRA Claims"). From 2003
6 until 2009 -- the relevant time period -- Dunakin was employed by
7 three different brokerage firms. Thornton FINRA Claim ¶ 10. In
8 September 2007, Dunakin was hired by GunnAllen Financial, Inc.
9 ("GAF"). Id. Defendants claim that Dunakin negligently managed
10 their investments and made misrepresentations to them, and that
11 they suffered financial losses as a consequence. E.g., id. ¶¶ 3-8.

12 Defendants initiated three separate arbitration proceedings
13 against Dunakin and GAF before FINRA (hereinafter, the "Escueta,"
14 "Im," and "Thornton" arbitrations). FINRA is a non-governmental
15 organization that, among other things, regulates brokerage firms
16 and exchange markets and arbitrates claims against FINRA members
17 that arise out of their securities dealings. Compl. ¶ 17.¹ Both
18 Dunakin and GAF are FINRA members. See Defs.' FINRA Claims.

19 In March 2010, Defendants -- all represented by the same
20 counsel -- amended their arbitration claims to add Sykes as a
21 respondent. See id. While Sykes never held an officer position
22 with GAF, he did occupy several positions with its parent company,
23 GunnAllen Holdings, Inc. ("GAH"), serving as its CEO and "non-
24 executive chairman," and sitting on its Board of Directors. Sykes

25
26 ¹ FINRA was established in 2007 when the National Association of
27 Securities Dealers, Inc. ("NASD") and the New York Stock Exchange
28 ("NYSE") consolidated their member-regulation operations into one
 self-regulatory organization. See Karsner v. Lothian, 532 F.3d
 876, 879 n.1 (D.C. Cir. 2008).

1 Decl. ¶¶ 7-8.² GAH is not a member of FINRA. Id. Sykes is also
2 an indirect majority owner of GAF. Mot. Ex. G ("GAF FINRA Report
3 Summary") at 128-134. Id. ¶ 7.³

4 In these amended claims, Defendants bring six causes of action
5 against Dunakin and GAF, including negligence and breach of
6 fiduciary duty. Id. ¶¶ 25-45. Defendants also name Sykes as one
7 of five respondents alleged to be GAF's officers and "control
8 persons." Id. ¶¶ 17-21. Against these individuals, Defendants
9 bring claims of negligent supervision and violation of Section
10 25400 of California's Corporations Code. Id. ¶ 29.

11 Sykes filed a motion for reconsideration of FINRA's approval
12 of Defendants' motions to amend their claims, and FINRA denied
13 these motions. Feldman Decl. ¶¶ 5-7, id. Ex. C.⁴ On August 27,
14 2010, Sykes initiated the present action, seeking declaratory
15 judgment that FINRA lacks jurisdiction over him, that he has not
16 breached any duty to Defendants, and is not liable for any of
17 Defendants' losses. ECF No. 1 ("Compl.") ¶ 1. In his Complaint,
18 Sykes seeks to permanently enjoin Defendants from continuing their
19 FINRA arbitration proceedings against him, compelling Defendants to
20 bring their claims against him in the present action. Id. On

21 ² Sykes filed a declaration in support of his Motion. Mot. Ex. H.

22 ³ Both parties rely on BrokerCheck, FINRA's online broker and
23 brokerage firm reporting service, to establish Sykes's relationship
24 with GAF. BrokerCheck's reports show that through a series of
25 entities, Sykes owned a majority of GAF as of April 2, 2010. GAF
26 FINRA Report Summary at 128-134. The chain of ownership is
27 serpentine: at least ninety percent of GAF is owned by GAH, with
the remaining percentage held by GAF's former CEO and president.
Id. GAH is, in turn, owned by GAH Holdings LLC, which is owned by
Hyde Park Equity Investments, LLC ("Hyde Park"). Id. More than
seventy-five percent of shares of Hyde Park are held by Sykes. Id.

28 ⁴ Jeffrey Feldman ("Feldman"), counsel for Defendants, filed a
declaration in support of Defendant's Opposition. Opp'n Ex. 5.

1 October 7, 2010, Sykes filed the present Motion, seeking a
2 preliminary injunction enjoining Defendants from pursuing him in
3 the FINRA proceedings. See Mot. The Im, Escueta, and Thornton
4 arbitrations are scheduled to commence on December 7, 2010, January
5 11, 2011, and April 5, 2011, respectively. Feldman Decl. ¶ 7.

6

7 **III. LEGAL STANDARD**

8 Under Federal Rule of Civil Procedure 65, a court may issue a
9 preliminary injunction to preserve the positions of the parties
10 until a full trial can be conducted. LGS Architects, Inc. v.
11 Concordia Homes, 434 F.3d 1150, 1158 (9th Cir. 2006). To warrant
12 such injunctive relief, a plaintiff "must establish that he is
13 likely to succeed on the merits, that he is likely to suffer
14 irreparable harm in the absence of preliminary relief, that the
15 balance of equities tips in his favor, and that an injunction is in
16 the public interest." Winter v. Natural Res. Def. Council, 129 S.
17 Ct. 365, 374 (2008).

18

19 **IV. DISCUSSION**

20 **A. Likelihood of Success on the Merits**

21 Sykes has the burden of establishing that he is likely to
22 succeed on the merits of his case. Winter, 129 S. Ct. at 374. The
23 issue underlying Sykes's Motion is whether FINRA lacks the
24 authority to hear a claim against him. See Mot. "[A]rbitration is
25 a matter of contract and a party cannot be required to submit to
26 arbitration any dispute which he has not agreed so to submit."
27 United Steelworkers of America v. Warrior & Gulf Navig. Co., 363
28 U.S. 574, 582 (1960). However, when an agreement to arbitrate

exists, federal courts have long recognized and enforced a "liberal federal policy favoring arbitration agreements." Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983). "Questions of arbitrability" -- such as whether an arbitration agreement exists and whether an arbitration clause covers the dispute in question -- are issues "for judicial determination unless the parties clearly and unmistakably provide otherwise." Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79, 83 (2002) (citing AT&T Techs., Inc. v. Commc'n Workers of America, 475 U.S. 643, 649 (1986)). Because the parties agree that there is no arbitration agreement between the Defendants and Sykes, see Opp'n at 4, and because neither party contends that FINRA rules clearly state that FINRA should determine the arbitrability of this dispute, the question of FINRA's jurisdiction over Sykes is within the purview of this Court.

While there is a public policy favoring arbitration, FINRA is a non-governmental agency, and it has no specific grant of authority -- from Congress or another some other font of governmental power -- to conduct arbitration proceedings. As such, its authority to compel arbitration must have some contractual basis -- either a contract between customer and FINRA member, or an agreement between the member and FINRA. See John Hancock Life Ins. Co. v. Wilson, 254 F.3d 48 (2d Cir. 2001) (finding that NASD member, by virtue of its membership in NASD, had agreed to arbitrate all disputes under Rule 10301 of the NASD Code of Arbitration).⁵ Sykes claims that he is not a FINRA member and has

⁵ The NASD Code of Arbitration was the predecessor to the FINRA Code, and FINRA has stated that it intended no substantive change

1 never consented to FINRA arbitration. Sykes Decl. ¶ 11.

2 Defendants do not dispute the veracity of these statements.
3 Rather, Defendants hinge their case on Rule 12200 of the FINRA
4 Code, which states that parties must arbitrate a dispute if:

5 [a]rbitration under the Code is either:

6 (1) Required by a written agreement, or
7 (2) Requested by the customer;

8 The dispute is between a customer and a member
9 or associated person of a member; and

10 The dispute arises in connection with the
11 business activities of the member or the
12 associated person, except disputes involving
13 the insurance business activities of a member
14 that is also an insurance company.

15 FINRA Proc. R. 12200.

16 Defendants argue that Rule 12200 should confer mandatory FINRA
17 arbitration over both FINRA members and "associated persons" of
18 FINRA members. Rule 12100(r) of the FINRA Code defines an
19 "associated person" as:

20 (1) A natural person who is registered or has
21 applied for registration under the Rules of
22 FINRA; or

23 (2) A sole proprietor, partner, officer,
24 director, or branch manager of a member, or
25 other natural person occupying a similar status
26 or performing similar functions, or a natural
27 person engaged in the investment banking or
28 securities business who is directly or
indirectly controlling or controlled by a
member, whether or not such person is
registered or exempt from registration with
FINRA under the By-Laws or the Rules of FINRA.

27 when it replaced NASD Rule 10301 with FINRA Rule 12200. See
28 Comparison Chart of Old and New NASD Arbitration Codes for Customer
Disputes, Rule 12200, www.finra.org/web/groups/rules_regs/documents/rule_filing/p018366.pdf.

1 For purposes of the Code, a person formerly
2 associated with a member is a person associated
2 with a member.

3 FINRA Proc. R. 12100(r).

4 Defendants argue that Rule 12100(r)(2) should be interpreted
5 to confer "associated person" status on anyone who is both (1)
6 engaged in the investment banking or securities business and (2)
7 directly or indirectly controlling a FINRA member. Opp'n at 4-7.
8 Defendants present evidence in the form of FINRA BrokerCheck
9 reports and news articles that Sykes was engaged in the investment
10 banking and securities business, and argue that this, when taken
11 with Sykes' indirect ownership of GAF, is sufficient to satisfy
12 Rule 12100(r)(2). Id. Defendants cite to no cases in support of
13 this interpretation, and cite no cases in which a Court compelled a
14 non-FINRA member to participate in arbitration.

15 The Court finds Defendants' proposed interpretation of the
16 FINRA Code is implausible and unsupported by the law. As the Court
17 has stated, FINRA's power to compel parties to arbitrate must be
18 rooted in some contract. Defendants' proffered interpretation
19 would eviscerate this requirement; Defendants essentially ask the
20 Court to find that FINRA has the authority, through its arbitration
21 code, to establish the outer jurisdictional limits of its
22 arbitration proceedings.

23 A more plausible reading of Rule 12200 is that any FINRA
24 member can be compelled to arbitrate a claim if there exists a
25 dispute between a customer and a person associated with the member,
26 and if the dispute arises in connection with the business
27 activities of the member or the associated person. Under this
28 reading, Rule 12200 does not define the class of individuals that

1 FINRA can compel to arbitrate; rather, it defines the range of
2 disputes FINRA can compel its members to arbitrate. This reading
3 is supported by Vestax Securities Corp. v. McWood, 280 F.3d 1078
4 (6th Cir. 2002). In that case, the Sixth Circuit affirmed a
5 district court's ruling compelling plaintiff Vestax to participate
6 in NASD arbitration proceedings initiated by defendants.
7 Defendants were investors who claimed they had been defrauded by
8 two Vestax-employed dealers. Id. at 1080. Vestax, an NASD member,
9 argued that the dispute was not subject to arbitration, because
10 defendants had purchased the securities from the two Vestax dealers
11 before they had become Vestax employees, and because the defendants
12 had never held an account with Vestax. Id. at 1081. Vestax argued
13 that, as a consequence, defendants were not "customers" of Vestax,
14 and thus the dispute was not between a "customer and a member
15 and/or associated person." Id. The district court held that the
16 broker-dealers were "associated persons" of Vestax, and thus the
17 defendants were customers of "associated persons" of Vestax,
18 justifying NASD jurisdiction under NASD rules. The Sixth Circuit
19 affirmed, writing that the NASD Code of Arbitration Procedure
20 "creates the right of parties to compel an NASD-member firm to
21 arbitrate even in the absence of a direct transactional
22 relationship with the firm." Id. Another case discussed by both
23 parties, Herbert J. Sims & Co., Inc. v. Roven, 548 F. Supp. 2d 759,
24 763 (N.D. Cal. 2008), also supports this reading. Like Vestax,
25 Sims turned on the question of whether the defendants were
26 "customers" of plaintiff, a FINRA member, thus requiring FINRA
27 arbitration of the dispute under Rule 12200. The court wrote that
28 "under the Code, customers can compel registered members of FINRA

1 to arbitrate certain disputes even when no written arbitration
2 agreement exists." Id. The court ultimately found that the
3 relationship between plaintiff and defendants was "too tenuous to
4 establish a customer relationship and compel arbitration." Id. at
5 766.

6 Because the uncontested evidence before the Court demonstrates
7 that Sykes is not and has never been a FINRA member and there is no
8 arbitration agreement between Sykes and Defendants, the Court finds
9 Sykes is very likely to succeed with the merits of his case.

10 **B. Irreparable Harm**

11 Because a preliminary injunction is an "extraordinary remedy
12 that may only be awarded upon a clear showing that the plaintiff is
13 entitled to such relief," Sykes must show that he is likely to
14 suffer irreparable injury in the absence of an injunction. Winter,
15 129 S. Ct. at 375-76. Winter overruled the previous test used by
16 the Ninth Circuit and other circuits which required a showing
17 irreparable injury was possible, rather than likely. See Johnson
18 v. Couturier, 572 F.3d 1067, 1081 (9th Cir. 2009) (applying the
19 Winter standard). Sykes cites to a handful of out-of-circuit cases
20 decided before Winter for the proposition that "forcing a party to
21 arbitrate a dispute that it did not agree to arbitrate constitutes
22 per se irreparable harm." Mot. at 13.

23 While the Court declines to adopt the per se rule Sykes
24 advances, at least one district court in this circuit has found,
25 post-Winter, that not staying a FINRA arbitration would likely
26 cause a plaintiff irreparable harm because it would leave it with
27 "no adequate remedy at law to recover the monetary and human
28 capital it would expend defending itself in arbitration." Sims,

1 548 F. Supp. 2d at 766. Given this lack of legal remedy and the
2 Court's determination of a high likelihood that FINRA lacks
3 jurisdiction over Sykes, the Court finds Sykes is likely to suffer
4 irreparable harm if the Defendants are not temporarily enjoined
5 from arbitrating before FINRA.

6 **C. Balance of Equities**

7 Sykes claims that the balance of equities favors preliminary
8 injunction, arguing that "the only 'harm' to Defendants would be
9 that they will have to proceed before this Court, rather than FINRA
10 arbitrators, and without the relaxed procedural rules that FINRA
11 provides." Mot. at 14. Defendants claim they will suffer
12 irreparable harm if the preliminary injunction is granted, claiming
13 they have "very limited resources," and because the arbitration
14 proceedings against Dunakin and the other respondents would likely
15 continue, these resources would have to be spread across two
16 different proceedings. Opp'n at 13.

17 Both parties' arguments are flawed, as they both analyze the
18 effects of a permanent injunction, rather than the temporary
19 injunction Sykes currently seeks. If a preliminary injunction is
20 granted, Defendants will be temporarily enjoined from bringing
21 proceedings against Sykes until the Court issues a final ruling on
22 whether FINRA has jurisdiction over Sykes. As such, Im and Escueta
23 would have to choose between continuing with their arbitrations,
24 bringing only their claims against the other respondents, and
25 filing a motion before FINRA to postpone the hearings. See FINRA
26 Proc. R. 12601. FINRA has the discretion to postpone a hearing.
27 Id. While Thornton may also have to make this choice, it is
28 possible this Court could come to a final resolution on FINRA's

1 jurisdiction over Sykes well before the hearing date. In light of
2 these considerations, the Court finds that Defendants will suffer
3 little harm from a preliminary injunction. As stated above, the
4 Court finds that Sykes is likely to suffer irreparable harm if
5 Defendants are not enjoined from proceeding with arbitration
6 against Sykes. For these reasons, the Court finds that the balance
7 of equities favors a preliminary injunction.

8 **D. Public Interest**

9 Sykes argues that a preliminary injunction will serve the
10 public interest because it will "minimize the risk that the parties
11 will suffer from the inconvenience, cost, and delay associated with
12 a protracted arbitration only to have any resulting award vacated
13 for want of jurisdiction," and "maintain the well-established rule
14 that parties are only required to arbitrate those claims which they
15 have agreed to arbitrate." Mot. at 14. Defendants argue that the
16 public interest is not served, because securities investors very
17 often sign agreements requiring them to arbitrate claims against
18 their brokers and brokerage firms with FINRA, and these investors
19 will have to bring separate court actions against the indirect
20 owners of those firms. Opp'n at 12.

21 The Court agrees that the public interest is not served by
22 compelling parties to arbitrate claims when there is no arbitration
23 agreement between the parties. Were it to deny Sykes's motion and
24 accept Defendants' interpretation of FINRA's Code, FINRA's
25 jurisdictional reach would extend beyond FINRA members and others
26 who have agreed to FINRA arbitration to all indirect controllers of
27 FINRA members in the investment banking and securities business,
28 regardless of whether these individuals were parties to an

1 arbitration agreement or otherwise consented to FINRA arbitration.
2 Such a reading would reach far beyond FINRA's authority and
3 foreclose the federal judicial system for a large number of
4 individuals. For these reasons, the Court finds this factor tips
5 in favor of Sykes.

6 Having found that all four Winter factors favor injunctive
7 relief, the Court GRANTS Plaintiff's Motion for Preliminary
8 Injunction. In addition, the Court finds that Sykes is not
9 required to post a bond per Rule 65(c) of the Federal Rules of
10 Civil Procedure because Defendants did not request that a bond be
11 posted or produce evidence that a bond is needed. See Connecticut
12 Gen. Life Ins. Co. v. New Images of Beverly Hills, 321 F.3d 878,
13 882-83 (9th Cir. 2003) (holding that if a party affected by an
14 injunction does not request that the Court set a bond or present
15 evidence that a bond is needed, the district court does not abuse
16 its discretion by not requiring a bond to be posted).

17

18 **v. CONCLUSION**

19 For the foregoing reasons, the Court GRANTS Plaintiff John H.
20 Sykes's Motion for Preliminary Injunction. Defendants Rosadia D.
21 Escueta, Paul Thornton, Chong A. Im, Kevin Im, and Jackie Im are
22 enjoined from pursuing Sykes in the following pending Financial
23 Industry Regulatory Authority arbitration cases: FINRA Arbitration
24 Nos. 09-05056 (Escueta v. GunnAllen Financial, et al.); 09-02238
25 (Thornton v. GunnAllen Financial, et al.); and 09-03838 (Im v.
26 GunnAllen Financial, et al.). This injunction shall remain in
27 force until trial or issuance of a dispositive court order on the
28 issue of FINRA's jurisdiction over Sykes. Sykes is not required to

1 post a bond per Rule 65(c).

3 IT IS SO ORDERED.

Dated: November 29, 2010

Samuel L. Hart
UNITED STATES DISTRICT JUDGE